Analyst: Nick Thillman

INVESTMENT MANAGEMENT CERTIFICATE PROGRAM February 12, 2018

Tools and Hardware

Stanley Black & Decker

Recommendation	Neutral
Target (today's value)	$170.00
Current Price	$160.13
52 week range	$125.33- $176.62

Share Data	
Ticker:	SWK
Market Cap. (Billion):	$24.5
Inside Ownership	0.7%
Inst. Ownership	82.6%
Beta	1.05
Dividend Yield	1.5%
Payout Ratio	30%
Cons. Long-Term Growth Rate	12.0%

	'15	'16	'17	'18E	'19E
Sales (billions)					
Year	$11.2	$11.4	$12.7	$13.3	$14.0
Gr %	-1.5%	2.1%	11.8%	5.6%	5.0%
Cons	-	-	$12.5	$13.4	$14.0
EPS					
Year	$5.96	$6.60	$7.42	$8.44	$9.64
Gr %	22.4%	10.7%	12.4%	13.7%	14.2%
Cons	-	-	$7.40	$8.32	$9.32

Ratio	'15	'16	'17	'18E	'19E
ROE (%)	14.3%	15.8%	16.3%	16.3%	16.5%
Industry	19.8%	27.5%	20.0%	20.1%	19.8%
NPM (%)	8.5%	8.5%	8.5%	9.0%	9.5%
Industry	10.4%	10.7%	10.8%	11.4%	11.9%
A. T/O	0.72	0.74	0.71	0.66	0.66
ROA (%)	5.7%	6.3%	6.3%	6.1%	6.6%
Industry	9.3%	8.2`%	8.1%	7.7%`	7.7%
A/E	2.50	2.51	2.51	2.61	2.49

Valuation	'16	'17	'18E	'19E
P/E	17.5	21.4	22.8	20.3
Industry	21.2	24.3	22.6	20.6
P/S	1.5	2.1	2.0	1.9
P/B	2.8	3.6	3.1	2.8
P/CF	11.48	19.7	16.4	15.3
EV/EBITDA	11.8	11.8	18.5	16.2

Performance	Stock	Industry
1 Month	-4.0%	3.4%
3 Month	-2.0%	32.3%
YTD	-5.6%	-19.4%
52-week	26.4%	2.7%
3-year	63.10%	-28.6%

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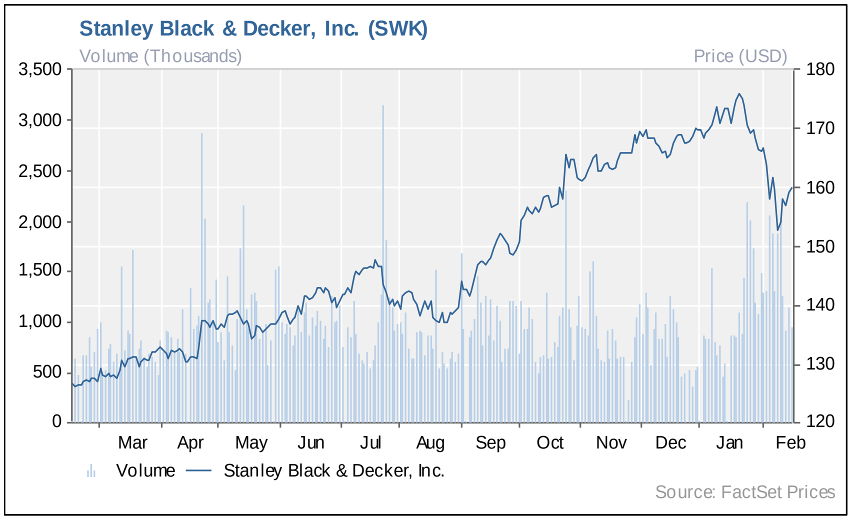


Summary: I recommend a neutral rating with a target of $170. Although SWK has the ability to improve efficiency and increase margins, stagnant foreign sales growth and future improvement in growth already being priced in has created doubt. The stock is fairly valued, based on relative and DCF analysis.

Key Drivers:

- Acquisition and divestment: SWK purchased Newell tools and Craftsman and sold part of its mechanical security line. SWK is moving resources from less profitable operations to areas where they have seen higher sales growth and profit margins.
- Foreign sales growth: SWK's foreign sales growth has been falling since 2013. Part of this was due to currency movements, but in 2016, only 1% can be attributed to movements
- Competition: SWK has not been able to grow its profit margin to the degree of its competition and is only helped by its large market share.

Valuation: Using a relative valuation approach, SWK is fairly valued compared to its peers. Due to greater precision of inputs, DCF analysis provides the best way to value the stock. A combination of the approaches suggests that Stanley Black & Decker is fairly valued, as the stock's value is about $170, and the shares trade at $160.13.

Risks: Threats to the business include declining international sales, foreign currency fluctuations, loss of brand identity, and competition.

Company Overview

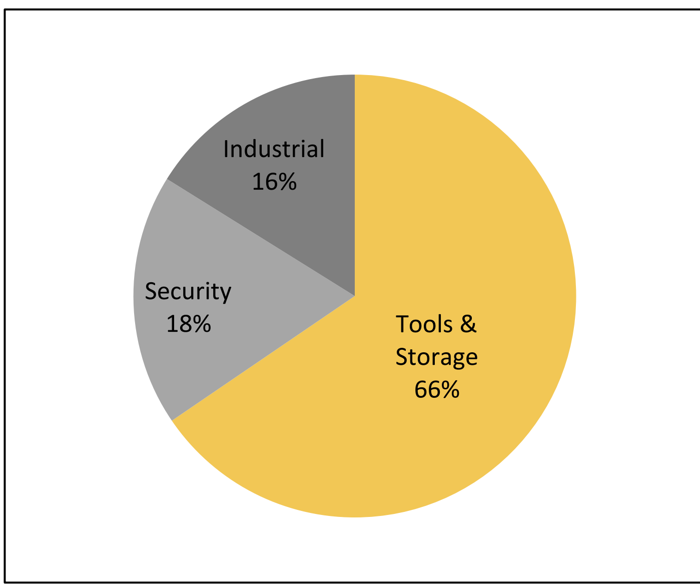
Stanley Black & Decker (SWK) is a global producer of hand tools, power tools and related accessories, electronic security and monitoring systems, healthcare solutions, engineered fastening systems and various other products and services for industrial applications. Stanley Black & Decker was founded in 1843 by Fredrick T. Stanley and is headquartered in New Britain, CT. In March 2010, the Company merged with The Black & Decker Corporation and changed its name from The Stanley Works to Stanley Black & Decker. The company services a wide variety of consumers that range from industrial professionals to ordinary homeowners. Stanley Black & Decker has a global footprint when it comes to its operations; nearly half of SWK's revenue (48%) is derived from international sources. SWK has continued its strategy of growth and acquisition through avenues such as geographic and customer diversification. Some of the firm's notable brands include the following: DEWALT, Black & Decker, and Stanley. SWK's high level of customer service has resulted in a loyal customer base. Stanley Black & Decker generates revenue from the following three segments:

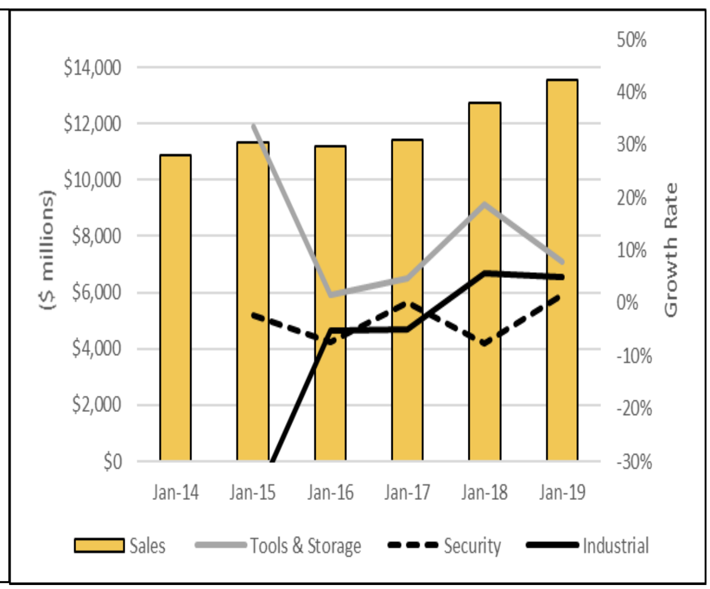
- Tools & Storage is comprised of the power and hand tools, accessories, and storage. It is sometimes referred to as the "Do It Yourself Division." Some of the products include drills, impact wrenches and drivers, saws, routers, sanders, nail guns, and lawn and garden products. It is the largest segment of SWK: 66% of total revenue. It has seen steady growth over the last four years, averaging 3.5% growth.

- Security is comprised of the convergent security solutions and mechanical access solutions. Some products include supplies and installs, and electronic security systems such as alarm monitoring, video surveillance, and system maintenance. The last four-year growth rate is 4.6%, underperforming relative to the Tool & Storage segment.

- Industrials include the engineered fastening and infrastructure businesses. Some of the products for the engineered fastening line include stud welding systems, engineered plastic and mechanical fasteners, and high-strength structural fasteners. The infrastructure business focuses on oil & gas and hydraulics businesses.

Figures 1 and 2: Revenue Sources for SWK, Year-end 2017 (left) and Revenue History since 2014 (right)





Source: Company reports

Business/Industry Drivers

Though several factors must be considered when analyzing Stanley Black & Decker's future success, the following are the most important business drivers:

1) Acquisitions and divestments
2) Foreign sales growth
3) Domestic and international competition
4) Macroeconomic Trends

Acquisition of Newell Tools

Stanley Black & Decker made several acquisitions and divestments over the past 12 months that will greatly impact future earnings. SWK recently purchased Newell Tools for $1.95 billion (around 15% of total revenue). In addition, the firm purchased Craftsman from Sears for $525 million and 2.5-3.5% of Craftsman's revenue over the next 15 years. Lastly, the company sold a majority of the mechanical security business for $725 million. These moves outline SWK's plan to shift resources from less profitable operations to areas where they have seen higher sales growth and profit margins.

Figure 3: 2016 Acquisitions and Divestments for SWK

(in $ Millions)	Value
Acquisitions:	
Newell Tools	$1,950
Craftsman	$525
Divestments:	
Mechanical Security	$725
Net Cash Flow	($1,750)

Source: Company reports

SWK reached an agreement to sell Craftsman products to Lowe's starting in 2018.

SWK's purchase of Newell Tools from Newall Brands closed in March of 2017. SWK increased its market share in the Tools and Storage segment, an area where the firm is already a large part of the market. Tools & Storage is 66% of revenue, and this acquisition will boost revenues to 10%. The Tools & Storage segment also had the highest profit margin for SWK in 2016. Based on past performance, the acquistion could net up to an additional $0.60 EPS by year three.

Figure 4: Newell Tools - past historical performance

	Sales ($) millions	Net Income ($) millions	Net Margin (%)	EPS conversion to SWK shares
2016	$ 761	$ 85	11.2%	$0.55*
2015	$ 791	$ 85	10.8%	$0.55*
2014	$ 852	$ 95	11.1%	$0.62*

Source: Company Reports

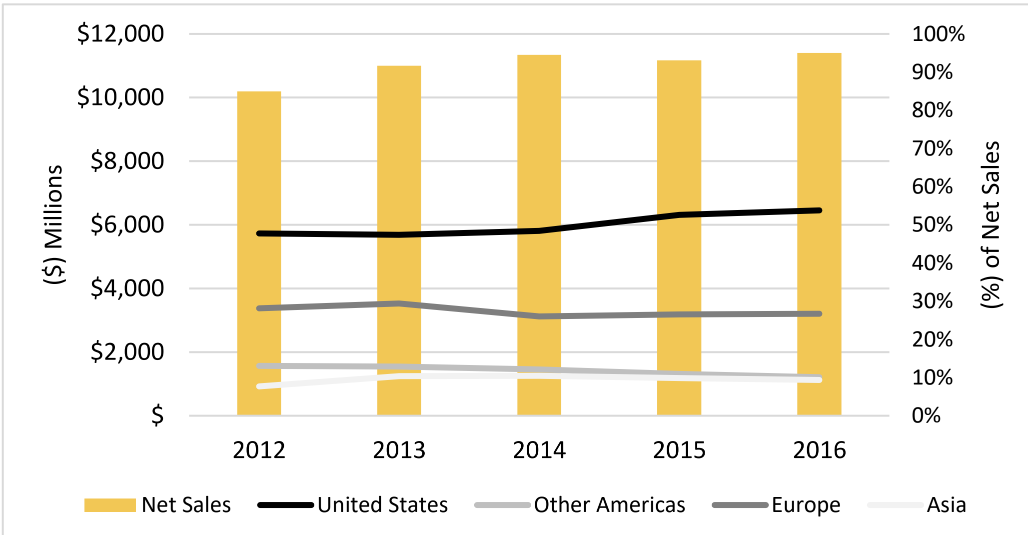
International revenue has been falling as a percent of sales since 2013.

Foreign Sales Growth

SWK has had organic growth through innovation and growth in foreign markets.

While SWK generates a large portion of revenue from outside the US and this presents opportunities, this business is shrinking in dollars, down $19 million in 2016, and as a percentage of sales, down 6% since 2013. The negative growth in 2016 is attributed to currency which drove sales down $250 million in 2016. In 2017, the dollar began to retreat and currency effects were less than one percent of sales compared to two percent in 2016.

Figure 5: Net Sales and % of Sales by Geography



Source: Company Reports

SWK's growth the last three years was driven by positive US growth.

Figure 6: Year over Year Growth Rate by Geographic Region

	2016	2015	2014	2013
Net Sales	2.1%	-1.5%	3.1%	8.0%
United States	4.3%	7.1%	5.4%	7.2%
Other Americas	-5.9%	-11.4%	-2.4%	6.3%
Europe	2.8%	-9.6%	1.5%	12.8%
Asia	-2.8%	-7.2%	4.0%	45.7%

Source: Company Reports

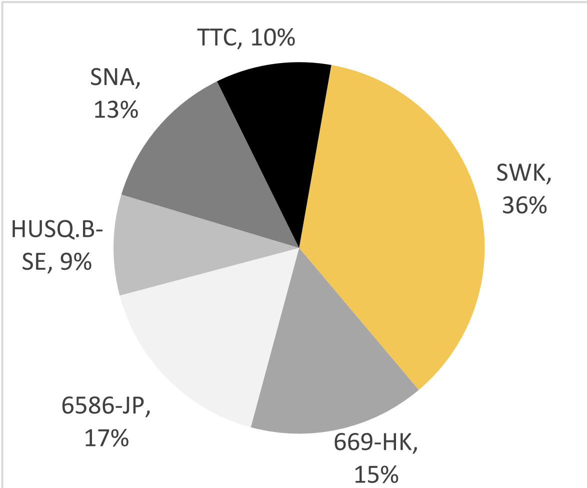
The Tools & Storage business has the highest profit margin of all business segments.

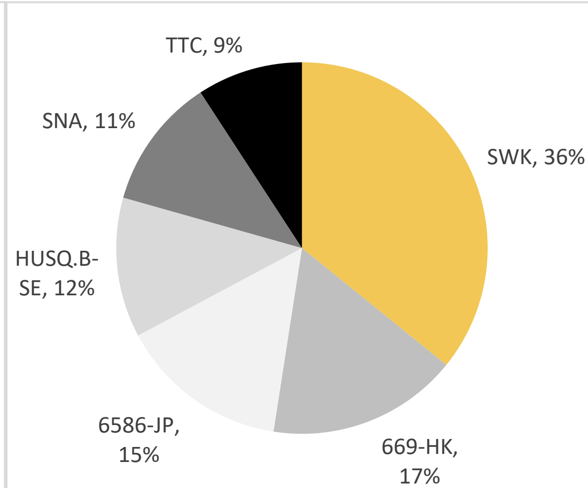
Competitor Analysis

The Tool & Storage industry is very competitive internationally and domestically. Major consumers are everyday people who are concerned with price and quality. Consumers have very inelastic demand for products because of many substitute products. As a result, it is important to monitor profit margins for signs that competitive pressures are leading to lower prices and profits.

SWK's percent of sales and percent of market cap are the same. This implies that the market believes that prospects for SWK and its competition are about the same.

Figures 8 and 9: Comparison of SWK comps by market cap (left) and Revenue (right)





Source: FactSet

Snap-On Incorporated (SNA) and Makita Corp (6586-JP) have higher profit margins than Stanley Black & Decker (SWK).

SWK's profit margins have been steadily increasing over the past five years as shown in Figure 10, but the margins are still below average. Its margins follow the industry, which have been improving over time. SWK's margins could jump as the firm offloads less profitable segments such as mechanical security operations and reallocates resources to the more profitable Tools & Storage segment.

Figure 10 Comparison of SWK and comps profit margins

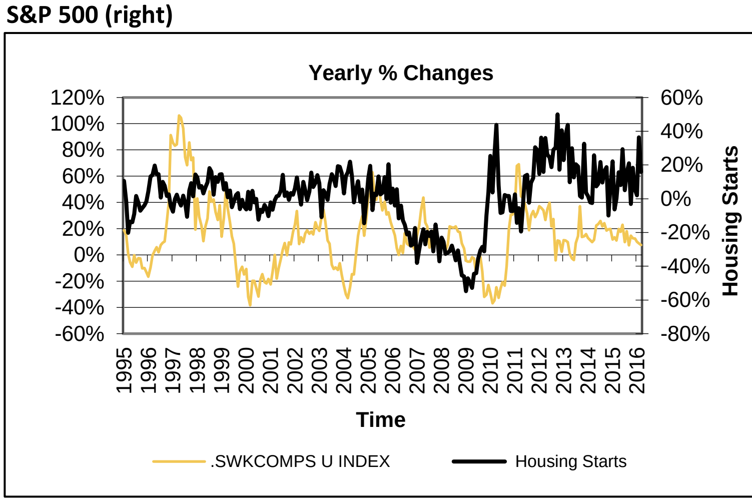
Company	2016	2015	2014	2013	2012
SWK	8.5%	8.1%	7.6%	4.7%	4.4%
SNA	14.5%	15.9%	12.1%	10.8%	9.9%
TTC	9.7%	8.5%	8.0%	7.58%	6.6%
HUSQVY	5.8%	5.2%	2.5%	3.0%	3.3%
6586-JP	10.8%	10.9%	10.0%	10.0%	10.1%
669-HK	7.5%	7.0%	6.3%	5.8%	3.9%

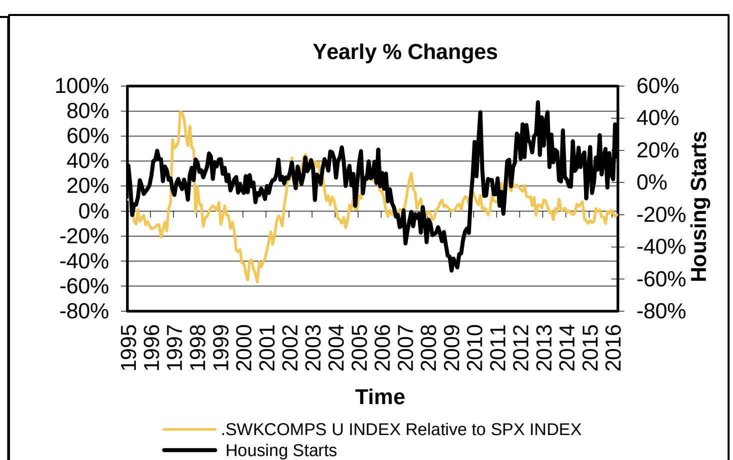
Source: FactSet

<u>Macroeconomic Trends</u>

While many believe that housing drives the industry since individuals need more tools as construction increases, housing starts only have a 0.02 correlation with the industry.

Figures 11 & 12: Housing Starts, Compared to SWK Comps (left), Housing Starts Compared to SWK Comps Relative to the S&P 500 (right)





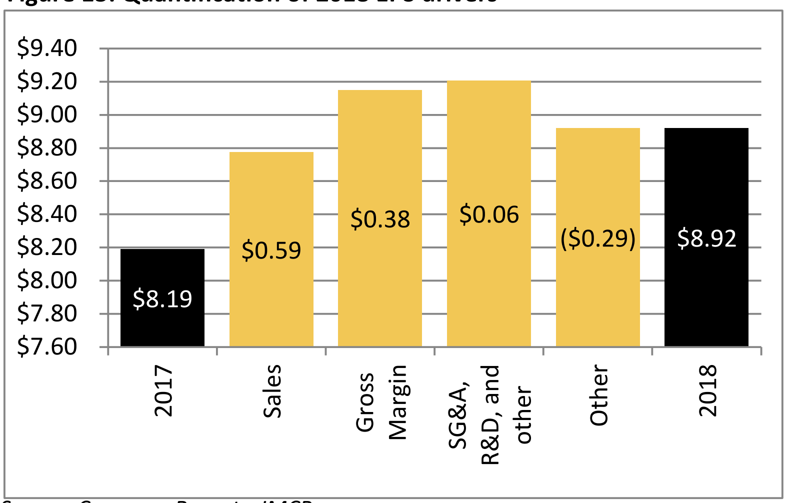
Source: Bloomberg, IMCP

The takeaway is that the industry is not entirely reliant on US housing. Of course, US sales are only 53% of total sales and many of the comps are foreign firms. However, this correlation proves the importance of the international market in diversifying SWK's business.

Financial Analysis

I anticipate EPS to grow to $8.92 in FY 2018. Sales will continue to receive a boost with the acquisitions of Newell Tools and Craftsman, contributing to approximately $0.59 in EPS assuming no change in profit margins. This sales growth will also be helped by SWK's renewed focus on its Tools segment. In addition, Gross Margins will increase due to the increase in production in the Tool segment, adding $0.38. To continue, reduction in SG&A as a percent of sales will add $0.06, due to divestment in SWK's Security segment which has low profit margins. Lastly, I forecast that SWK will continue to pay restructuring costs from the acquisition, lowering EPS $0.29.

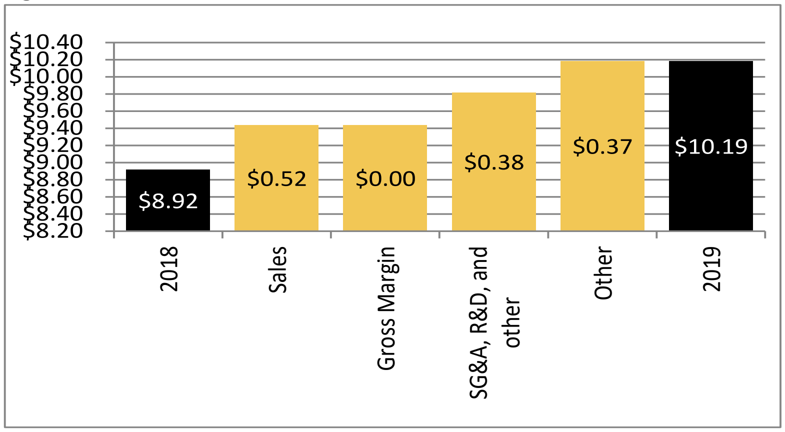
Figure 13: Quantification of 2018 EPS drivers



Source: Company Reports, IMCP

I expect 2019 EPS to increase $1.27 to $10.37. Sales will continue to climb with the addition of Craftsman tool sales in 2018. Furthermore, sales in the emerging market will continue to improve, helped by the falling of the US dollar, resulting in a net EPS increase of $0.52. I anticipate a reduction in SG&A as SWK's supply chain efficiency improves. With continued growth of the Tools & Storage segment as a percent of sales, SG&A as a percentage of sales will decrease, resulting in a higher EBIT margin, adding $0.38 to EPS. In addition, the ending of restructuring costs of the previous mergers will increase EPS by $0.37

Figure 14: Quantification of 2019 EPS drivers



Source: Company Reports, IMCP

Figure 15: EPS and YoY growth estimates

	FY 2018E	FY2019E
YoY Growth	6%	5%
Revenue-Consensus	$13,415	$14,156
YoY Growth	7%	6%
EPS-Estimate	$8.39	$9.33
YoY Growth	3%	11%
EPS-Consensus	$8.32	$9.32
YoY Growth	1%	12%

Source: FactSet

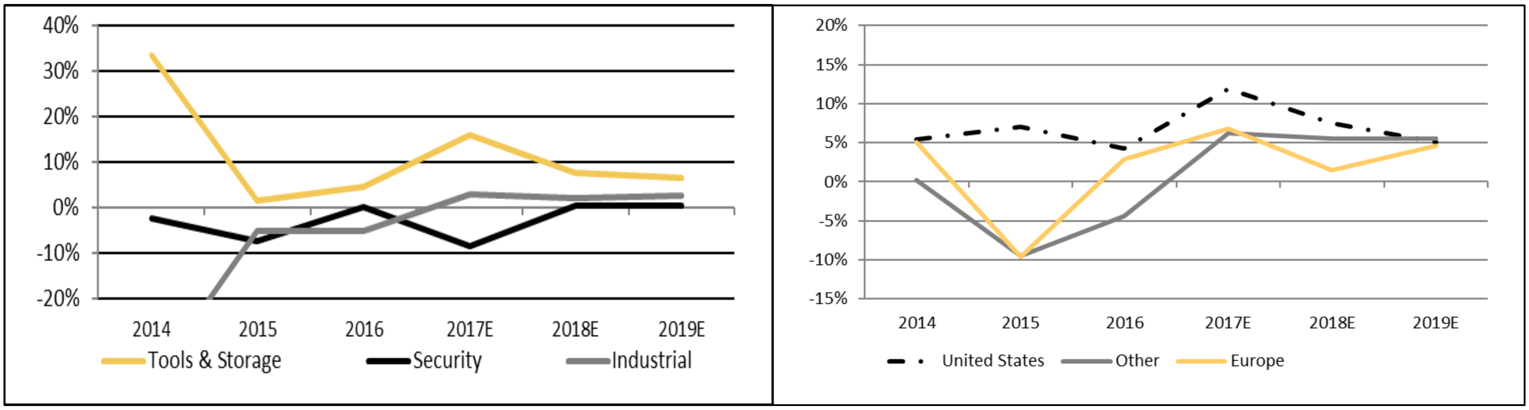
I am close to consensus estimates for 2018 and 2019 in sales. In 2018, I expect sales to grow at 6% compared to 7% by consensus. In all, I expect earnings to outperform 2018 estimates by a large margin. These earnings will continue to improve in 2019 as SWK continues to improve its supply chain and finalizes all its restructuring from its recent acquisition.

Revenues

Stanley Black & Decker's revenue growth rebounded since 2015. Recent economic trends in the US have helped boost revenue growth, but growth will slow as the economy cools down. I expect growth rates will rise, carried by a strengthening Tools & Storage segment due to recent acquisitions, along with the weakening of the dollar vs Euro and emerging market currencies. Sales growth in Tools & Storage will fall back to normal levels of 5% by 2019 after rising 10% in 2017 due to the acquisition. SWK's industrial division has had stable growth, and I project growth of 5% in 2018 and 2019. The security division will decline in 2017 due to the divestment in 2016 and will recover back to positive growth rates by 2019.

International revenue rebounds to 5% growth in 2017 and maintains this in 2018 and 2019 due to the weakening of the US dollar relative to the Euro and emerging market currencies. Continued expansion of SWK's production operation to other countries could also help offset any possible losses from currency if my assumption for exchange rates is incorrect.

Figures 16 &17: Stanley Black and Decker segment revenue growth rate, 2014-2019E, geographical growth rates, 2014-2019E

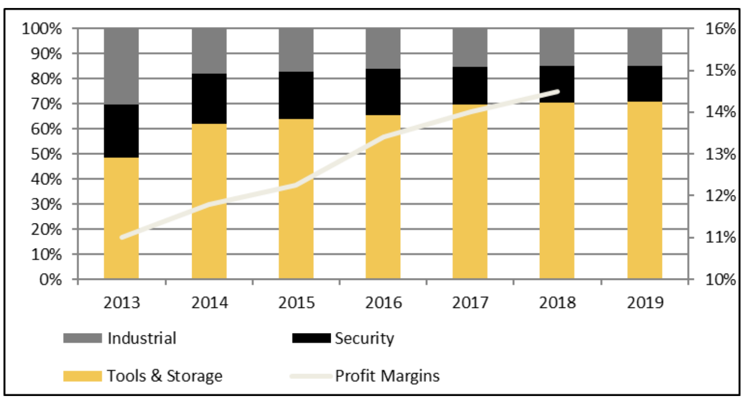


Source: Company Reports

Operating Income and Margins

Operating margins are expected to rise as SWK focuses more on improvements to its supply chain and places more focus on its Tools & Storage segment. By 2018, the division will make up 70% of SWK's total revenue. The higher weight should help boost EBIT margins as the Tools & Storage segment is the most profitable. In addition, restructuring will be finished by 2019, resulting in a more efficient and less expensive supply chain.

Figures 17 and 18 segment % of sales 2013-2019E, 2016 segment profit margin



2016 Segment Summary		
	Sales	Profit Margin
Tools and Storage	$7,469	17.0%
Security	$2,097	12.8%
Industrials	$1,840	16.5%

Source: Company Reports

In addition, the industrials segment is growing with the economy after three years of decline and will have high margins.

Return on Equity

Stanley Black & Decker's ROE has risen from 11.4% in 2014 to 16.7% in 2017 and will fall to 15.6% by 2019. EBIT margins are expected to improve over time. Improvements in SWK's supply chain, divestment of unprofitable businesses and the firm's focus on 5-6% organic growth will boost margins.

Figure 19: ROE breakdown, 2014 – 2019E

5-stage Dupont	2014	2015	2016	2017	2018E	2019E
EBIT / sales	11.0%	11.8%	12.3%	13.4%	14.0%	14.5%
Sales / avg assets	0.70	0.72	0.74	0.73	0.69	0.69
EBT / EBIT	86.9%	87.4%	87.7%	89.3%	92.8%	93.4%
Net income /EBT	70.1%	76.8%	78.7%	80.3%	75.7%	79.0%
ROA	4.7%	5.7%	6.3%	7.1%	6.8%	7.4%
Avg assets / avg equity	2.42	2.50	2.51	2.37	2.24	2.12
ROE	11.4%	14.3%	15.8%	16.7%	15.2%	15.6%

Source: Company Reports

Higher margins are offset somewhat by lower asset turns. However, lower interest and tax burdens contribute to a higher ROA. ROE is still rising even as the firm deleverages. A/E will decline as the increase in assets is lower than the rise in equity. I forecast no additional debt in 2018-19.

Free Cash Flow

SW's free cash flow has been volatile over the last several years. I forecast that NOPAT will grow rapidly over the course of the next three years. This will be offset by increases in net operating capital due to restructuring. Net working capital excluding cash will slowly increase due to SWK acquiring many new assets.

Figure 20: Free cash flows 2014 – 2019E

Free Cash Flow	2014	2015	2016	2017	2018E	2019E
NOPAT	$987	$1,032	$1,100	$1,372	$1,519	$1,654
Growth	*52.1%*	*4.5%*	*6.6%*	*24.8%*	*10.7%*	*8.9%*
NOWC	1,118	862	1,985	210	420	1,229
Net fixed assets	11,900	11,466	10,846	14,514	15,238	15,495
Total net operating capital	$13,019	$12,328	$12,832	$14,723	$15,658	$16,725
Growth	*-4.9%*	*-5.3%*	*4.1%*	*14.7%*	*6.3%*	*6.8%*
- Change in NOWC	(55)	(256)	1,123	(1,776)	210	809
- Change in NFA	(618)	(435)	(619)	3,667	724	258
FCFF	$1,660	$1,723	$596	-$520	$585	$587
Growth		*3.8%*	*-65.4%*	*-187.2%*	*212.5%*	*0.3%*
- After-tax interest expense	129	130	135	147	109	109
+ Net new short-term and long-	(351)	(47)	25	(971)	-	-
FCFE	$1,180	$1,546	$486	-$1,637	$475	$477
Growth		*31.0%*	*-68.6%*	*-437.0%*	*129.0%*	*0.4%*

Source: Company Reports, IMCP

I expect both FCFF and FCFE to bounce back in 2018 after being negative as a result of acquisitions. In 2018 and 2019 growth in NOPAT was 7.9%, with most of it being used for acquisition purposes. FCFF will rebound in 2018 and 2019 due to growth in NOPAT (7.9% and 5.8%) and will outpace increases in NFA and NOWC (5.6% and 5.9%).

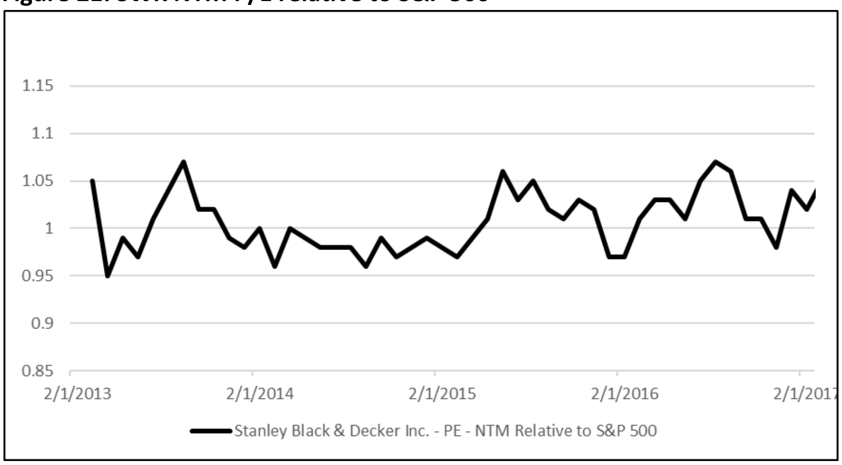
Valuation

SWK was valued using multiples and a 3-stage discounting cash flow model. Based on earnings multiples, the stock is slightly expensive relative to other firms and is worth $184. Price to book valuation yielded a price of $183. A detailed DCF analysis values SWK slightly higher, at $171. Lastly, a probability-weighted scenario analysis values the stock at $177.54. As a result of these valuations, I value the stock at $175.

Trading History

SWK is currently trading at its five-year relative NTM P/E high to the S&P 500. This is the result of steady increases in earnings and the fact that most analysts project earnings to continue to grow at above market rates. SWK's current NTM P/E is at 19.9 compared to its five year average of 19.5. I do not expect regression towards that number as the economy continues to heat up.

Figure 21: SWK NTM P/E relative to S&P 500



Source: Factset

Assuming the firm maintains a 19.9 NTM P/E at the end of 2018, it should trade at $202.78 by the end of the year.

- Price = P/E x EPS = 19.9x $10.19 = $202.78

Discounting $202.78 back to today at a 10.4% cost of equity (explained in Discounted Cash Flow section) yields a price of $183.67. Given SWK's potential earnings growth and continued profitability, this seems to be a reasonable valuation for current market conditions. However, I am also more bullish on near-earnings than consensus.

Relative Valuation

Stanley Black & Decker is currently trading at a P/E much lower than its peers, with a P/E TTM of 21.0 compared to an average of 25.4. Investors may be skeptical of SWK delivering consistent and sustainable earnings growth (12.4% EPS growth in 2017, 13.7% EPS growth in 2018, and 12.4% in 2019). SWK's P/S ratio is also lower than its peers which reflects its lower operating margin.

Figure 22: SWK comparable companies

Ticker	Name	Current Price	Market Value	Price Change 1 day	1 Mo	3 Mo	6 Mo	52 Wk	YTD	Earnings Growt LTG	NTM	2016	2017	2018	2019	Pst 5yr	Beta	LT Debt Equity	S&P Rating	LTM Dividend Yield	Payout
SWK	STANLEY BLACK & DECKER INC	$169.16	$25,941	(0.8)	1.0	3.4	18.9	36.1	(0.3)	12.0	4.4%	2.1%	12.4%	13.7%	12.4%	20.7%	1.28	34.3%	B+	1.43%	30.1%
SNA	SNAP-ON INC	$181.03	$10,320	(1.0)	3.6	13.2	20.7	1.1	3.9	8.3	9.8%	13.4%	13.6%	9.6%	10.6%	14.8%	1.05	25.8%	A	1.69%	29.2%
TTC	TORO CO	$66.97	$7,140	(0.2)	2.9	6.5	(6.4)	12.0	2.7		9.9%	15.3%	36.4%	17.0%	8.3%	17.8%	0.49	49.5%	A	1.11%	29.0%
DHR	DANAHER CORP	$102.70	$71,439	1.3	9.9	13.3	25.3	26.7	10.6	8.1	24.9%	1.1%	-16.1%	10.4%	10.9%	5.4%	1.02	42.3%	A	0.60%	16.1%
6586-JP	MAKITA CORP	$46.83	$12,712	(1.5)	6.4	12.7	18.1	29.5	7.5	10.2	19.8%	3.0%	-8.6%	16.5%	18.2%	6.9%	0.65	0.0%		1.08%	28.6%
669-HK	TECHTRONIC INDUSTR	$6.30	$11,553	(0.5)	(0.2)	11.2	34.6	84.1	(3.3)			18.8%	15.8%	18.2%	19.2%	18.9%	0.18			1.13%	
Average			$23,184	(0.5)	3.9	10.1	18.5	31.6	3.5	9.6	13.7%	8.9%	8.9%	14.2%	13.3%	14.1%	0.78	30.4%		1.17%	26.6%
Median			$12,133	(0.7)	3.3	12.0	19.8	28.1	3.3	9.2	9.9%	8.2%	13.0%	15.1%	11.7%	16.3%	0.83	34.3%		1.12%	29.0%
SPX	S&P 500 INDEX	$2,839		0.1	5.8	11.0	14.6	23.5	6.2			-0.1%	0.5%	10.3%	11.7%						

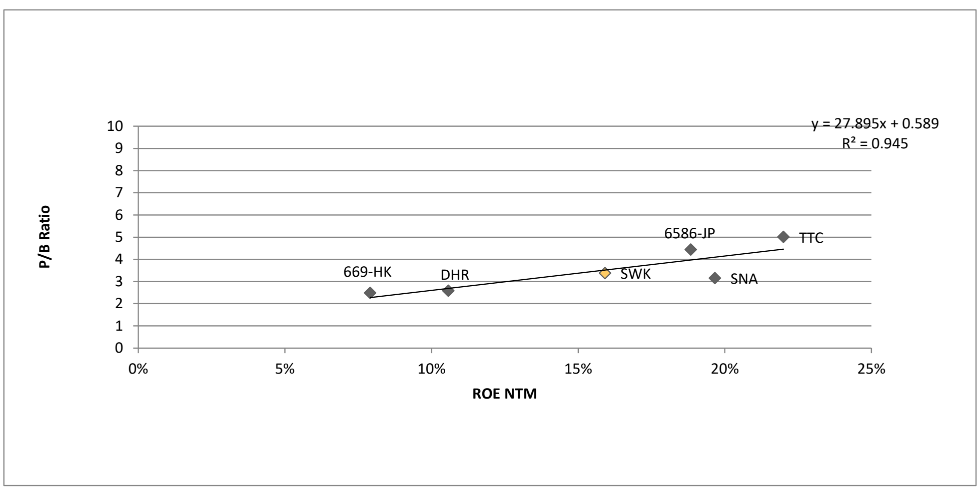
Ticker	Website	2017 ROE	P/B	P/E 2015	2016	2017	TTM	NTM	2018	2019	2017 NPM	2017 P/S	OM	ROIC	EV/ EBIT	P/CF Current	P/CF 5-yr	Sales Growth NTM	STM	Pst 5yr	Book Equity
SWK	http://www.stanleyblackanddecker.com	13.7%	3.57	16.9	18.4	17.6	21.0	20.1	22.9	20.3	8.8%	2.27	12.9%	11.5%	17.7	18.9	13.1	7.2%	5.7%	4.6%	$47.38
SNA	http://www.snapon.com	17.9%	3.53	19.2	21.2	18.6	18.6	16.9	18.0	16.2	13.9%	2.74	23.3%	16.5%	12.3	13.6	13.5	-5.0%	4.0%	4.8%	$51.25
TTC	http://www.thetorocompany.com	35.7%	11.60	24.4	24.2	27.2	27.8	25.3	27.8	25.7	9.2%	2.99	14.2%	29.7%	19.8	22.2	18.5	5.2%	5.3%	5.0%	$5.77
DHR	http://www.danaher.com	8.4%	2.81	17.9	19.2	25.3	30.3	24.3	30.2	27.2	12.7%	4.23	16.2%	6.3%	22.0	20.9	15.7	6.0%	4.3%	1.0%	$36.49
6586-JP	http://www.makita.co.jp	7.2%	2.67	16.9	21.0	26.4	29.3	24.5	31.6	26.8	9.8%	3.61	15.1%	9.1%	13.9	23.2	15.9			7.0%	$17.55
669-HK	http://www.ttigroup.com	15.9%	4.56	20.1	21.5	16.3			24.2	20.3	7.4%	2.11		14.8%	14.0	17.3	11.3			8.3%	$1.38
Average		16.5%	4.79	19.2	20.9	21.9	25.4	22.2	25.8	22.8	10.3%	2.99	16.3%	14.6%	16.6	19.3	14.7	3.3%	4.8%	5.1%	
Median		14.8%	3.55	18.5	21.1	21.9	27.8	24.3	26.0	23.0	9.5%	2.86	15.1%	13.2%	15.9	19.9	14.6	5.6%	4.8%	4.9%	

A more thorough analysis of P/B and ROE is shown in figure 23. The calculated R-squared of the regression indicates that 94.5% of a sampled firm's P/B is explained by its NTM ROE. SWK has below average P/B and ROE of this grouping, and according to this measure is slightly undervalued.

- Estimated P/B = Estimated 2018 ROE (15.9%) x 27.895-0.5809 = 3.86
- Target Price = Estimated P/B (3.86) x 2018E BVPS ($47.36) = $182.81

Discounting $182.81 back to the present at a 10.4% cost of equity leads to a target price of $165.59 using this metric.

Figure 23: P/B vs NTM ROE



Source: Factset

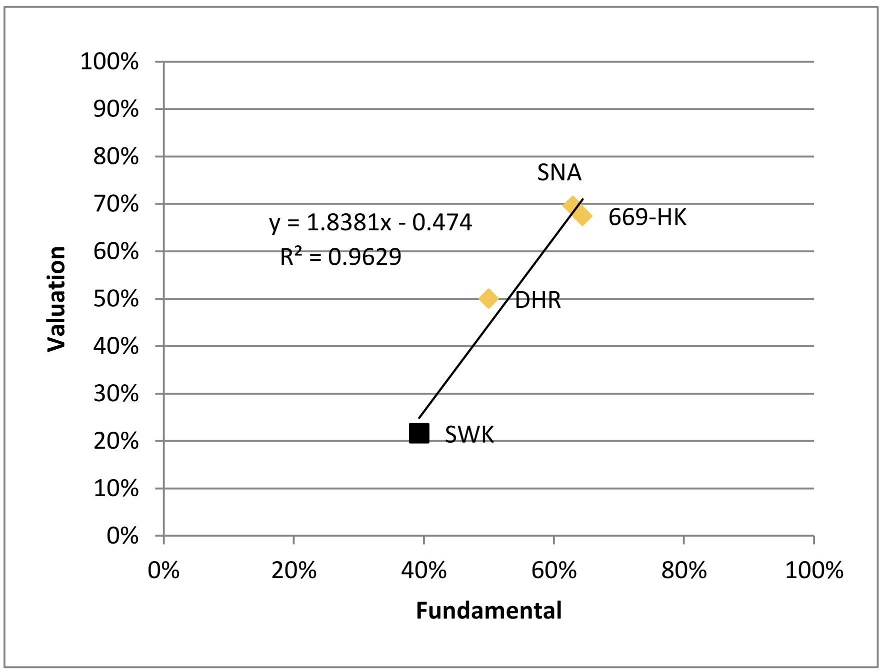
For a final comparison, I created a composite ranking of several valuation and fundamental metrics. Since the variables have different scales, each was converted to a percentile before calculating the composite score. An equal weighting of NTM earnings growth and 2017 ROE were compared to an equal weight composite of 2016 P/E and P/B. After eliminating Toro Co and Makita Corp which were both outliers, the regression line had an R-squared of 0.96. One can see that SWK is near the line, meaning that it is fairly valued using fundamental analysis.

Figure 24: Composite valuation, % of range

		Fundamentals		Valuation			
	Weight	50%	50%	50%	50%		
Ticker	Name	Earnings Growth NTM	ROE	2016 P/E	P/B	Fund	Value
SWK	STANLEY BLACK & DECKER INC	0%	79%	0%	43%	39%	22%
SNA	SNAP-ON INC	26%	100%	98%	41%	63%	70%
DHR	DANAHER CORP	100%	0%	100%	0%	50%	50%
669-HK	TECHTRONIC INDUSTR	50%	79%	35%	100%	64%	67%

Source: IMCP

Figure 25: Composite relative valuation



Source: IMCP

Discounted Cash Flow Analysis

A three stage discounted cash flow model was also used to value DCF.

For the purpose of this analysis, the company's cost of equity was calculated to be 10.4% using the Capital Asset Pricing Model. The underlying assumptions used in calculating this rate are as follows:

- The risk-free rate, as represented by the ten year Treasury bond yield, is 2.33%.
- A beta of 1.05 was utilized since the company has slightly higher risk than the market and its performance has aligned with the S&P 500.
- A long term market rate of return of 10% was assumed, since historically, the market has generated an annual return of about 10%.

Given the above assumptions, the cost of equity is 10.40% (2.33 + 1.05 (10.0 – 2.33)).

Stage One - The model's first stage simply discounts fiscal years 2018 and 2019 free cash flow to equity (FCFE). These per share cash flows are forecasted to be ($1.00) and $8.46, respectively. Discounting these cash flows, using the cost of equity calculated above, results in a value of $6.04 per share. Therefore, stage one of this discounted cash flow analysis contributes $6.04 to value.

Stage Two - Stage two of the model focuses on fiscal years 2020 to 2024. During this period, FCFE is calculated based on revenue growth, NOPAT margin and capital growth assumptions. The resulting cash flows are then discounted using the company's 10.40% cost of equity. I assume a conservative 5% growth rate from 2020-2024. The ratio of NWC to sales will fall back to 2017 levels and NFA turnover will gradually rise from 0.92 in 2020 to 0.94 in 2021 as a result of improvements in operations, in part due to acquisitions. Also, the NOPAT margin is expected to rise to 13.5% in 2023 from 12.0% in 2020 due to continued synergies in the Tool Segment from acquisitions.

Figure 25: FCFE and discounted FCFE, 2018 – 2024

	2018	2019	2020	2021	2022	2023	2024
FCFE	($1.00)	$8.46	$3.41	$9.59	$9.21	$6.48	$12.24
Growth		*749.4%*	*-59.7%*	*181.5%*	*-4.0%*	*-29.6%*	*88.9%*

Source: IMCP

Added together, these discounted cash flows total $20.09.

Stage Three – Net income for the years 2020– 2024 is calculated based upon the same margin and growth assumptions used to determine FCFE in stage two. EPS is expected to grow from $11.24 in 2020 to $14.92 in 2024.

Figure 26: EPS estimates for 2018-2024

	2018	2019	2020	2021	2022	2023	2024
EPS	$8.92	$10.19	$11.51	$11.84	$12.71	$13.63	$15.20

Source: IMCP

Stage three of the model requires an assumption regarding the company's terminal price-to-earnings ratio. For the purpose of this analysis, it is generally assumed that as a company grows larger and matures, its P/E ratio will converge near to the historical average of the S&P 500. Stanley Black & Decker, on the other hand will not face this situation. SWK's comps average NTM P/E is 22.2 and SWK has seen a steady increase in P/E over time. As a result, a P/E ratio of 19.50 is assumed at the end of SWK's terminal year. This P/E multiple though seeming rather high, fits the conditions of today's market and the possible future as the firm is a strong company with good brands.

Given the assumed terminal earnings per share of $14.92 and a price to earnings ratio of 19.5, a terminal value of $290.90 per share is calculated. Using the 10.40% cost of equity, this number is discounted back to a present value of $145.69.

Total Present Value – given the above assumptions and utilizing a three stage discounted cash flow model, an intrinsic value of $170.26 is calculated (4.48 + 20.09 + 145.69). Given SWK's current price of $169.69, this model indicates that the stock is fairly valued.

Scenario Analysis

To better understand the catalysts in determining SWK's stock price, I valued the firm using six scenerios that are based on changes in NOPAT margin and sales growth.

Figure 27: Scenario analysis

Sales	NOPAT Margin	DCF Value	Probability	Weighted Average
Strong Growth p=0.25	Growing (p=0.5)	$191.35	12.50%	$23.92
	Stable (p=0.5	$183.42	12.50%	$22.93
Modest Growth p=0.50	Growing (p=0.5)	180.99	25%	$45.25
	Stable (p=0.5	$173.73	25%	$43.43
Weak Growth p=0.25	Growing (p=0.5)	171.37	12.50%	$21.42
	Stable (p=0.5	$164.75	12.50%	$20.59

If SWK is unable to maintain its consistent sales growth of 5% annually, the value drops to $164.75. However, if NOPAT margins are able to improve from 11.5% to 12.5% as SWK moves more into the Tool industry, value increases by nearly $7 across all estimates. The scenario analysis shows that NOPAT margin is the more important in determining SWK's value compared to sales. It appears the market is expecting moderate growth with stable margin for SWK.

Business Risks

Although I have many reasons to be optimistic about Stanley Black &Decker, there are several good reasons why I find the stock to be fairly priced only a few dollars below its 52-week high:

Global Competition:

Stanley Black & Decker competes with both larger and smaller companies that offer similar products, but are located in countries in which labor and other production costs are substantially lower. SWK may have to reduce prices on its products and services to stay competitive and retain market share.

Business Risks were derived from SWK's 10-K

Change in customer preferences:

Customers change what they demand all the time. If SWK does not adapt the to the needs of its customers, SWK could see a decline in sales.

Loss of brand reputation:

SWK's biggest asset is its brand recognition. It keeps the firm profitable and competitive. If the company violates trademark agreements and product requirements, its brand could be damaged.

Exposure to currency fluctuations:

Nearly 50% of SWK's revenues are denominated in currencies other than the dollar. Strengthening of the dollar relative to currencies such as the Euro could reduce margins.

Possible Valuation Changes

If SWK is able to increase profit margins at a faster rate, the stock may become a buy. Profit margins are key driver in SWK's stock price and buy bringing those future cash flows closer to present time will increase the stock's valuation.

SWK could be considered a sell if current market conditions deteriorate. SWK's current valuation is dependent on strong sales growth over the near future. If the economy (especially in the US) sees a sudden slowing of consumer spending, SWK's valuation could change drastically.

Appendix 1: Income Statement

Income Statement (in $ millions)	2013	2014	2015	2016	2017	2018E	2019E
Sales	$10,890	$11,338	$11,172	$11,406	$12,747	$13,561	$14,255
Direct costs	6,986	7,235	7,100	7,085	7,969	8,408	8,838
Gross Margin	3,904	4,103	4,072	4,321	4,778	5,153	5,417
SG&A, R&D, and other	3,169	2,854	2,756	2,924	3,069	3,255	3,350
EBIT	735	1,248	1,316	1,397	1,709	1,899	2,067
Interest	147	164	165	171	183	137	137
EBT	588	1,085	1,151	1,226	1,526	1,762	1,930
Taxes	69	227	249	261	301	352	386
Income	519	858	902	965	1,226	1,410	1,544
Other	29	97	19	0	0	75	20
Net income	490	761	884	965	1,225	1,335	1,524
Basic Shares	155.2	156.1	148.2	146.0	149.6	149.6	149.6
EPS	$3.16	$4.87	$5.96	$6.60	$8.19	$8.92	$10.19
DPS	$1.93	$1.93	$2.14	$2.26	$2.42	$2.68	$3.06

Appendix 2: Balance Sheet

Balance Sheet (in millions)	2013	2014	2015	2016	2017	2018	2019
Cash	469	497	465	1,132	460	842	1,669
Operating assets ex cash	3,547	3,452	3,197	3,657	4,560	4,824	4,929
Operating assets	4,017	3,949	3,662	4,789	5,020	5,666	6,598
Operating liabilities	2,843	2,830	2,800	2,803	3,464	3,618	3,803
NOWC	1,173	1,118	862	1,985	1,556	2,048	2,796
NOWC ex cash (NWC)	704	622	397	854	1,096	1,206	1,127
NFA	12,519	11,900	11,466	10,846	14,647	15,056	15,309
Invested capital	*$13,692*	*$13,019*	*$12,328*	*$12,832*	*$16,203*	*$17,103*	*$18,105*
Marketable securities	-	-	-	-	-	-	-
Total assets	*$16,535*	*$15,849*	*$15,128*	*$15,635*	*$19,667*	*$20,721*	*$21,907*
Short-term and long-term debt	$4,192	$3,841	$3,795	$3,820	$4,393	$4,393	$4,393
Other liabilities	2,619	2,665	2,674	2,639	2,639	2,639	2,639
Debt/equity-like securities	-	-	-	-	728	728	728
Equity	6,881	6,512	5,859	6,374	7,247	8,148	9,149
Total supplied capital	*$13,692*	*$13,019*	*$12,328*	*$12,832*	*$15,006*	*$15,907*	*$16,908*
Total liabilities and equity	*$16,535*	*$15,849*	*$15,128*	*$15,635*	*$18,470*	*$19,525*	*$20,711*

Appendix 3: Sales Forecast

Sales (in millions)	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19
Sales	10,890	11,338	11,172	11,406	12,747	13,561	14,255
Growth		*4.1%*	*-1.5%*	*2.1%*	*11.8%*	*6.4%*	*5.1%*
Tools & Storage	5,271	7,033	7,141	7,469	8,862	9,548	10,121
Growth		*33.4%*	*1.5%*	*4.6%*	*18.7%*	*7.7%*	*6.0%*
% of sales	*48.4%*	*62.0%*	*63.9%*	*65.5%*	*69.5%*	*70.4%*	*71.0%*
Security	2,316	2,261	2,093	2,097	1,939	1,970	2,009
Growth		*-2.4%*	*-7.4%*	*0.2%*	*-7.5%*	*1.6%*	*2.0%*
% of sales	*21.3%*	*19.9%*	*18.7%*	*18.4%*	*15.2%*	*2.0%*	*14.1%*
Industrial	3,303	2,044	1,938	1,840	1,946	2,043	2,125
Growth		*-38.1%*	*-5.2%*	*-5.1%*	*5.8%*	*5.0%*	*4.0%*
% of sales	*30.3%*	*18.0%*	*17.3%*	*16.1%*	*15.3%*	*15.1%*	*6.0%*
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
United States	5,208	5,492	5,882	6,136	7,011	7,459	7,841
Growth		*5.5%*	*7.1%*	*4.3%*	*14.3%*	*6.4%*	*5.1%*
% of sales	*47.8%*	*48.4%*	*52.6%*	*53.8%*	*55.0%*	*55.0%*	*55.0%*
Canada	600	591	516	515	561	597	641
Growth		*-1.5%*	*-12.7%*	*-0.2%*	*8.8%*	*6.4%*	*7.5%*
% of sales	*5.5%*	*5.2%*	*4.6%*	*4.5%*	*4.4%*	*4.4%*	*4.5%*
Other Americas	818	788	707	636	663	705	784
Growth		*-3.6%*	*-10.4%*	*-10.0%*	*4.3%*	*6.4%*	*11.2%*
% of sales	*7.5%*	*7.0%*	*6.3%*	*5.6%*	*5.2%*	*5.2%*	*5.5%*
France	705	696	596	583	637	678	713
Growth		*-1.3%*	*-14.4%*	*-2.2%*	*9.4%*	*6.4%*	*5.1%*
% of sales	*6.5%*	*6.1%*	*5.3%*	*5.1%*	*5.0%*	*5.0%*	*5.0%*
Other Europe	2,418	2,585	2,372	2,469	2,677	2,848	2,922
Growth		*6.9%*	*-8.3%*	*4.1%*	*8.4%*	*6.4%*	*2.6%*
% of sales	*22.2%*	*22.8%*	*21.2%*	*21.6%*	*21.0%*	*21.0%*	*20.5%*
Asia	1,141	1,186	1,100	1,069	1,195	1,271	1,354
Growth		*4.0%*	*-7.2%*	*-2.8%*	*11.8%*	*6.4%*	*6.5%*
% of sales	*10.5%*	*10.5%*	*9.8%*	*9.4%*	*9.4%*	*9.4%*	*9.5%*

Appendix 4: Ratios

Ratios	2014	2015	2016	2017	2018	2019
Profitability						
Gross margin	36.2%	36.4%	37.9%	37.5%	38.0%	38.0%
Operating (EBIT) margin	11.0%	11.8%	12.3%	13.4%	14.0%	14.5%
Net profit margin	6.7%	7.9%	8.5%	9.6%	9.8%	10.7%
Activity						
NFA (gross) turnover	0.93	0.96	1.02	1.01	0.91	0.93
Total asset turnover	0.70	0.72	0.74	0.73	0.69	0.69
Liquidity						
Op asset / op liab	1.40	1.31	1.71	1.05	1.09	1.27
NOWC Percent of sales	10.1%	8.9%	12.5%	8.6%	2.3%	5.8%
Solvency						
Debt to assets	24.2%	25.1%	24.4%	14.9%	14.1%	13.4%
Debt to equity	59.0%	64.8%	59.9%	34.3%	30.8%	27.7%
Other liab to assets	16.8%	17.7%	16.9%	18.7%	17.8%	16.8%
Total debt to assets	41.1%	42.8%	41.3%	33.7%	31.9%	30.2%
Total liabilities to assets	58.9%	61.3%	59.2%	56.5%	54.1%	51.6%
Debt to EBIT	3.08	2.88	2.73	1.67	1.50	1.38
EBIT/interest	7.63	7.97	8.16	9.36	13.89	15.12
Debt to total net op capital	29.5%	30.8%	29.8%	19.3%	18.2%	17.0%
ROIC						
NOPAT to sales	8.7%	9.2%	9.6%	10.8%	11.2%	11.6%
Sales to NWC	17.10	21.94	18.25	59.90	(1,288.14)	34.16
Sales to NFA	0.93	0.96	1.02	1.01	0.91	0.93
Sales to IC ex cash	0.88	0.92	0.97	0.99	0.91	0.90
Total ROIC ex cash	7.7%	8.5%	9.3%	10.6%	10.2%	10.5%
NOPAT to sales	8.7%	9.2%	9.6%	10.8%	11.2%	11.6%
Sales to NOWC	9.89	11.28	8.01	11.62	43.08	17.29
Sales to NFA	0.93	0.96	1.02	1.01	0.91	0.93
Sales to IC	0.85	0.88	0.91	0.93	0.89	0.88
Total ROIC	7.4%	8.1%	8.7%	10.0%	10.0%	10.2%
NOPAT to sales	8.7%	9.2%	9.6%	10.8%	11.2%	11.6%
Sales to EOY NWC	18.23	28.17	13.36	(29.79)	33.33	33.33
Sales to EOY NFA	0.95	0.97	1.05	0.88	0.89	0.92
Sales to EOY IC ex cash	0.91	0.94	0.97	0.90	0.87	0.90
Total ROIC using EOY IC ex cash	7.9%	8.7%	9.4%	9.7%	9.7%	10.4%
NOPAT to sales	8.7%	9.2%	9.6%	10.8%	11.2%	11.6%
Sales to EOY NOWC	10.14	12.96	5.75	60.82	32.29	11.60
Sales to EOY NFA	0.95	0.97	1.05	0.88	0.89	0.92
Sales to EOY IC	0.87	0.91	0.89	0.87	0.87	0.85
Total ROIC using EOY IC	7.6%	8.4%	8.6%	9.3%	9.7%	9.9%
EBIT / sales	11.0%	11.8%	12.3%	13.4%	14.0%	14.5%
Sales / avg assets	0.70	0.72	0.74	0.73	0.69	0.69
EBT / EBIT	86.9%	87.4%	87.7%	89.3%	92.8%	93.4%
Net income /EBT	70.1%	76.8%	78.7%	80.3%	75.7%	79.0%
ROA	4.7%	5.7%	6.3%	7.1%	6.8%	7.4%
Avg assets / avg equity	2.42	2.50	2.51	2.37	2.24	2.12
ROE	11.4%	14.3%	15.8%	16.7%	15.2%	15.6%

Appendix 5: 3-stage DCF Model

		2018	2019	2020	2021	2022	2023	2024
		First Stage		**Second Stage**				
Sales Growth		*6.4%*	*5.1%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
NOPAT / S		*11.2%*	*11.6%*	*12.0%*	*12.0%*	*12.5%*	*12.5%*	*13.0%*
S / NWC		*33.33*	*33.33*	*12.50*	*12.50*	*12.50*	*12.50*	*12.50*
S / NFA (EOY)		*0.89*	*0.92*	*0.92*	*0.93*	*0.93*	*0.94*	*0.94*
S / IC (EOY)		*0.87*	*0.90*	*0.86*	*0.87*	*0.87*	*0.87*	*0.87*
ROIC (EOY)		*9.7%*	*10.4%*	*10.3%*	*10.4%*	*10.8%*	*10.9%*	*11.4%*
ROIC (BOY)			*10.6%*	*11.3%*	*10.8%*	*11.4%*	*11.4%*	*11.9%*
Share Growth			*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Sales		$13,561	$14,255	$14,968	$15,717	$16,503	$17,328	$18,194
NOPAT		$1,519	$1,654	$1,796	$1,886	$2,063	$2,166	$2,365
Growth			*8.9%*	*8.6%*	*5.0%*	*9.4%*	*5.0%*	*9.2%*
- Change in NWC		835	21	770	60	63	66	69
NWC EOY		*407*	*428*	*1197*	*1257*	*1320*	*1386*	*1456*
Growth NWC			*5.1%*	*180.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
- Chg NFA		724	258	775	630	845	689	922
NFA EOY		*15,238*	*15,495*	*16,270*	*16,900*	*17,745*	*18,434*	*19,355*
Growth NFA			*1.7%*	*5.0%*	*3.9%*	*5.0%*	*3.9%*	*5.0%*
Total inv in op cap		1559	278	1545	690	908	755	991
Total net op cap		15644	15923	17467	18157	19065	19820	20811
FCFF		($40)	$1,375	$252	$1,196	$1,155	$1,411	$1,374
% of sales		*-0.3%*	*9.6%*	*1.7%*	*7.6%*	*7.0%*	*8.1%*	*7.6%*
Growth			*-3567.2%*	*-81.7%*	*375.4%*	*-3.5%*	*22.2%*	*-2.6%*
- Interest (1-tax rate)		109	109	114	118	123	128	133
Growth			*0.0%*	*4.0%*	*4.0%*	*4.0%*	*4.0%*	*4.0%*
FCFE w/o debt		($149)	$1,266	$138	$1,078	$1,032	$1,283	$1,241
% of sales		*-1.1%*	*8.9%*	*0.9%*	*6.9%*	*6.3%*	*7.4%*	*6.8%*
Growth			*-949.4%*	*-89.1%*	*681.8%*	*-4.3%*	*24.3%*	*-3.3%*
/ No Shares		149.6	149.6	149.6	149.6	149.6	149.6	149.6
FCFE		($1.00)	$8.46	$0.92	$7.20	$6.90	$8.57	$8.29
Growth			*-949.4%*	*-89.1%*	*681.8%*	*-4.3%*	*24.3%*	*-3.3%*
* Discount factor		0.91	0.82	0.74	0.67	0.61	0.55	0.50
Discounted FCFE		($0.90)	$6.94	$0.69	$4.85	$4.21	$4.74	$4.15
			Third Stage					
Terminal value P/E								
	Net income	$1,335	$1,524	$1,682	$1,768	$1,940	$2,038	$2,232
	% of sales	*9.8%*	*10.7%*	*11.2%*	*11.2%*	*11.8%*	*11.8%*	*12.3%*
	EPS	$8.92	$10.19	$11.24	$11.81	$12.96	$13.62	$14.92
	Growth		*14.2%*	*10.4%*	*5.1%*	*9.7%*	*5.1%*	*9.5%*
	Terminal P/E							19.50
	* Terminal EPS							$14.92
	Terminal value							$290.90
	* Discount factor							0.50
	Discounted terminal value							$67.68

Summary

First stage	$6.04	Present value of first 2 year cash flow
Second stage	$18.64	Present value of year 3-7 cash flow
Third stage	$145.69	Present value of terminal value P/E
Value (P/E)	**$170.37**	= value at beg of fiscal yr 2018

Appendix 6: Porter's 5 Forces

Threat of New Entrants - Low

New entrants are rare in the tools and hardware industry due to the large amounts of capital needed in order to enter the marketplace. In addition, the companies already in the industry have loyal customers.

Threat of Substitutes - High

Stanley Black & Decker has strong brand recognition that attracts and keeps loyal customers. Lower cost options are still there and place a threat to growing profit margins.

Buyer Power- High

It is difficult for Stanley Black & Decker to increase profit margins due to consumer's elasticity of demand. Consumers have numerous other options in the tools and hardware industry and have a high degree of power over the manufacturer.

Supplier Power- Low

Suppliers compete on price in the industry because of the interchangeable nature of raw materials.

Competitive Rivalry- High

SWK's competitive threat can mostly be found in the international market. Most of the major players in the industry are foreign-based so fluctuations in the US dollar can have a great affect SWK's international market share.

Appendix 7: SWOT Analysis

Strengths	Weaknesses
Well-known brands Large Market Share	Margins Currency Fluctuations
Opportunities	**Threats**
Acquisitions Economic Conditions Emerging Markets	Loss of Customers Lack of Product Diversity